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612172—44

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 460

ACME BREWING CO., A CORPORATION, PETITIONER

v.

CLIFFORD C. ANGLIM, COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF CALIFORNIA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The District Court rendered no opinion. The opinion of the Circuit Court of Appeals (R. 161–166) is reported at 143 F. 2d 412.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 26, 1944 (R. 167), and the petition for rehearing was denied on August 11, 1944 (R. 168). The petition for a writ of certiorari was filed on September 12, 1944. The jurisdiction of this Court is invoked under Sec-

tion 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a written contract entered into between the two sole stockholders of the petitioner corporation on their own behalf, the provisions of which were carried out by petitioner to its benefit, is "a written contract executed by the corporation" within the meaning of Section 26 (c) (1) of the Revenue Act of 1936 so as to entitle petitioner to a credit against 1937 surtax on undistributed profits.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 26. CREDITS OF CORPORATIONS.
>
> In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—
>
> * * * * *
>
> (c) *Contracts Restricting Payment of Dividends.*—
>
> (1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a

corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26–2. *Credit in connection with contracts restricting payment of dividends.*—(*a*) The credit provided in section 26 (c) with respect to contracts restricting the payment of dividends is not available under every contract which might operate to restrict the payment of dividends, but only with respect to those provisions of written contracts executed by the corporation prior to May 1, 1936, which satisfy the conditions prescribed in the Act. The charter of a corporation does not constitute a written contract executed by the corporation within the meaning of section 26 (c). The provisions recognized by the Act are of two general types, as follows:

(1) Those which come within section 26 (c) (1), in that they prohibit or limit the payment of dividends during the taxable year; and

* * * * *

(*b*) *Prohibition on payment of dividends.*—The credit provided in section 26

(c) (1) is allowable only with respect to a written contract executed by the corporation prior to May 1, 1936, which expressly deals with the payment of dividends and operates as a legal restriction upon the corporation as to the amounts which it can distribute within the taxable year as dividends. * * *

* * * * *

STATEMENT

On November 18, 1941, petitioner, a California corporation having its principal place of business in San Francisco, filed suit in the United States District Court for the Northern District of California for refund of $75,997.18, alleged to have been illegally collected in 1939 as undistributed profits surtax for the calendar year 1937, together with interest thereon (R. 2–7, 12–13, 16–17). Payment of the $75,997.18 had resulted from the denial of petitioner's claim for credit against undistributed profits surtax under Section 26 (c) (1) of the Revenue Act of 1936 (R. 15). The contract (see *infra,* pp. 5–8) upon which petitioner relied for credit under Section 6 (c) (1) was executed on December 13, 1934 (R. 15). The Commissioner deemed it binding on petitioner so far as payment of dividends in 1936 was concerned, but disallowed credit for 1937 on the ground that petitioner was in a financial position during that year to pay off its indebtedness and

thereby remove the dividend restriction contained in the contract (R. 15–16, 35–36).

The Collector of Internal Revenue, by answer filed in the District Court, denied that the 1937 tax, together with interest, had been illegally collected (R. 8–11). A hearing was held, at which evidence was received (R. 20–139). The District Court subsequently filed findings of fact and conclusions of law (R. 12–18), finding that petitioner was actuated by sound business reasons, that its board of directors had acted reasonably and in good faith in not paying off the indebtedness and removing the contractual dividend restriction in 1937 (R. 16), and that the contract relied upon by petitioner for credit was a written contract executed by petitioner prior to May 1, 1936, and contained a provision binding petitioner not to pay dividends during 1937 (R. 15).[1] Accordingly, the court rendered judgment for petitioner (R. 18–20). On appeal, the Circuit Court of Appeals reversed the judgment of the District Court (R. 167), holding that the contract was not one executed by the petitioner corporation (R. 160–166).

The pertinent facts with respect to the contract may be summarized as follows:

In December 1934, the capital stock of petitioner (formerly known as the California Brewing

[1] The court's findings of fact did not include the facts upon which this latter conclusion was based.

Association of Southern California) was owned 80% by the Cereal Products Refining Corporation (later known as Acme Breweries, but referred to hereinafter as Cereal) and 20% by the Bohemian Distributing Company (hereinafter referred to as Bohemian (R. 20–21, 22, 44, 100–101, 102).

On December 13, 1934, Cereal and Bohemian entered into a written contract, each on its own behalf (R. 44). In the contract both parties agreed that petitioner's board of directors should be increased to seven members and petitioner's stock voted so that Cereal could select five directors and Bohemian two out of certain named persons (R. 49); that petitioner's capital structure should be altered so as to provide 100,000 shares of stock at $10 par value (R. 45); that each party would purchase 10,000 additional shares of stock in the petitioner corporation (R. 45–46); and that, if petitioner sold or offered any additional stock for sale, the stock should first be offered to Cereal and Bohemian in proportion to their respective holdings (R. 49). Bohemian agreed to give Cereal the first opportunity, and a 30-day option, to purchase any stock in petitioner which Bohemian desired to sell (R. 49). Cereal agreed to sell petitioner cooperage, bottles and cases to the value of $100,000; to accept 15,000 shares of stock from petitioner in satisfaction of $150,000 petitioner owed it (R. 45); and to lend petitioner $350,000 for the construction of a plant, the loan

to be evidenced by a promissory note secured by a deed of trust (R. 46–47, 48). Both parties agreed that the loan was to be paid off in designated installments and that, in the event petitioner did not have sufficient surplus to pay an installment, each would advance petitioner an amount in proportion to its respective stockholding in petitioner, to enable petitioner to meet the installment (R. 47–48). This provision was stated not to be made for the benefit of petitioner (R. 48). In the same paragraph, the parties agreed that petitioner should have the option of paying installments prior to their due date if it had sufficient earnings and cash surplus to justify such payments (R. 48). Immediately following this provision, the contract provided (R. 48):

> It is understood that the California Brewing Association of Southern California [petitioner] shall not pay any dividends to stockholders until said loan of $350,000.00 is entirely liquidated, together with all accrued interest.

Without referring to this contract, petitioner's board of directors subsequently passed resolutions conforming to the plan detailed in the contract (see, *e.g.*, R. 55, 56–57). With respect to the $350,000 loan, petitioner's board of directors passed a resolution to borrow an additional $50,000 from Cereal to satisfy an outstanding mortgage and to execute a promissory note, secured by a trust deed, in the amount of $400,000 (R. 56–57).

No mention of the contract or dividend restriction was made in the resolution, promissory note, or trust deed. Bohemian gave its written consent to Cereal to loan petitioner the additional $50,000 and to increase the amount of the promissory note to $400,000 (R. 51). The dividend restriction was mentioned by petitioner for the first time on March 8, 1937, when petitioner's board of directors passed a resolution to request Cereal to allow it to pay dividends on preferred stock, stating that petitioner was bound by the restriction (R. 65–66).

ARGUMENT

Petitioner contends (Pet. 18–31) that the written contract between its two stockholders, Cereal and Bohemian, was one "executed by the [petitioner] corporation" within the meaning of Section 26 (c) (1) of the Revenue Act of 1936, *supra*, pp. 2–3, because the corporation passed resolutions to carry the contract into effect and received benefits from it. We submit that the contention is unsound.

The fact that a contract between two parties inures to the benefit of a third party may, in some instances, permit the third party beneficiary to enforce the contract against the party from whom the benefits are to move, but the acceptance of benefits from the contract does not make the third party beneficiary a party to it or subject to its liabilities. See 2 Williston on Contracts (1936

ed.) pp. 1041–1161. The performance of a contract and acceptance of its benefits may make one a party to a contract when the acceptance of benefits constitutes a ratification of the contract. Mechem, Agency (1923 ed.) pp. 89–93. But in such a case the elements of ratification must be present. *Ibid.* To be ratified, a contract must have been made by someone purporting to act as the agent of another (*id.*, pp. 75–77, 79, 82–83) and, when ratified, the agent is released from liability under it (*id.*, pp. 96–97). Here, neither Cereal nor Bohemian purported to act as petitioner's agent; the contract was binding on them when made, and remained so. Hence, it was a contract "executed" by Cereal and Bohemian. They could, of course, carry out its provisions through their control of petitioner's board of directors and thus make the contract binding on petitioner. This fact is immaterial, however, for a credit under Section 26 (c) (1) may result only from a written contract "executed by the corporation," and, as this Court held in *Helvering* v. *Northwest Steel Mills,* 311 U. S. 46, the section is to be strictly construed against the taxpayer. A corporation is, of course, an entity separate and distinct from its stockholders.[2]

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[2] None of the state decisions cited by petitioner (Pet. 18–19, 25–27) conflicts with the statements made in this paragraph. The decisions merely apply the above-stated rules or involve the acceptance of an offer to a contract by performance, or are otherwise inapplicable.

Petitioner asserts, however, that the Court should review the case in order to clarify its decision in *Helvering* v. *Northwest Steel Mills, supra,* on the question whether Section 26 (c) (1) requires a contract signed by the corporation, and to resolve an asserted conflict between the decision below and decisions of other Circuit Courts of Appeals on the question (Pet. 7–9, 31). However, the court below stated that the contract was neither signed nor authorized by petitioner; that neither Cereal nor Bohemian entered into it as agent of petitioner; that it was never expressly ratified or adopted by petitioner; that petitioner's first reference to it by resolution passed on May 8, 1937, failed to satisfy the statutory requirement of a written contract executed prior to May 1, 1936; and that, although petitioner was to a large extent a third party beneficiary, the statute contemplated something more (R. 165–166). In sum, therefore, the court held that the case involves no corporate act which could be deemed an execution of a contract in any sense of the word "execute" (Sec. 26 (c) (1)). Conversely, in *Helvering* v. *Northwest Steel Mills, supra,* and the allegedly conflicting Circuit Court decisions, there was a corporate act which might be deemed an execution of a contract and it was pertinent to inquire whether Section 26 (c) (1) contemplates only an "execution" by signature of the corporation. That question is irrelevant here and, hence, review of the

instant case by this Court will not aid in clarifying the Court's decision in the *Northwest Steel Mills* case or in resolving any conflict on the question between the Circuit Courts of Appeals. The decision below is, in fact, in accord with the other decisions which involve similar circumstances. See *Caroline Mills* v. *Commissioner,* 126 F. 2d 857 (C. C. A. 5th); *Phebus Oil Co.* v. *Commissioner,* 134 F. 2d 217 (C. C. A. 5th); *Bolivian International Mining Corp.* v. *Commissioner,* 1 T. C. 1110, affirmed *per curiam,* 142 F. 2d 556 (C. C. A. 2d), pending on petition for certiorari in No. 436.

CONCLUSION

The decision below is correct and involves no important question of law or real conflict of decisions. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
MELVA M. GRANEY,
Special Assistants to the Attorney General.

OCTOBER 1944.

U. S. GOVERNMENT PRINTING OFFICE: 1944